Report

of the

Examination of

Arch Specialty Insurance Company

New York, New York

As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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January 14, 2005

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Honorable Walter A. Bell
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Commissioners:

In accordance with the instructions of the Wisconsin Commissioner of Insurance, a compliance examination has been made of the affairs and financial condition of:

ARCH SPECIALTY INSURANCE COMPANY
New York, New York

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Arch Specialty Insurance Company (ASIC or the company) was conducted in 1999-2000 as of December 31, 1998, by the Illinois Department of Insurance. The current examination covered the intervening period ending December 31, 2003, and included a review of such 2004 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Prior examination recommendations were considered for this examination but will not be commented on since they relate to the company prior to redomestication to Wisconsin.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance. The actuary reviewed the adequacy of the company's loss and loss adjustment expense reserves. The actuary's results were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

The company was incorporated under the laws of Illinois on December 22, 1964, and commenced writing business on January 28, 1965, as Rock River Insurance Company (RRIC). The company was organized by Deere and Company with authorized capital of $2,500,000 consisting of 100,000 authorized common shares and was originally owned by Sierra General Life Insurance Company (25%) and Deere and Company (75%). Upon liquidation of Sierra General Life Insurance Company, as approved by the Nevada Commissioner of Insurance on November 3, 1995, with an effective date of September 30, 1995, the shares of the company were assumed by John Deere Insurance Group.

On September 30, 1999, Sentry Insurance a Mutual Company (SIAMCO) purchased RRIC and the company was redomesticated to Wisconsin in July 2000. On February 1, 2002, Arch Capital Group Ltd. (ACGL), a Bermuda company, purchased RRIC through a stock purchase agreement. Under this agreement, all obligations of the company existing prior to the acquisition were reinsured by SIAMCO under a 100% quota share reinsurance agreement, which is supported by a guarantee agreement by SIAMCO. On April 30, 2002, ACGL contributed the company to Arch Capital Group (U.S.) Inc. (Arch-US), a Delaware corporation. Arch-US then contributed the company to Arch Reinsurance Company (Arch Re), a Nebraska corporation, which eventually contributed the company to Arch Insurance Group Inc. (AIGI), a Delaware corporation (formally a Missouri corporation), which in turn contributed the company to Arch Insurance Company (AIC), a Missouri corporation. The company changed its name from RRIC to Arch Specialty Insurance Company, its current name, on August 1, 2002.

A Stipulation and Order was issued when the change of control was approved. The order states:

1. The company shall not enter into any affiliated reinsurance agreement unless the affiliate has established a reinsurance credit trust on behalf of the company under an agreement approved by this office.
2. The company shall not recognize credit for reinsurance with Arch Reinsurance Ltd., for purposes of computing the company's compulsory and security surplus pursuant to ss. 623.11 and 623.12, Wis. Stat., for any accounting period, unless all of the following conditions are continuously maintained:

a. Any reinsurance credit trust established by Arch Reinsurance Ltd. on behalf of the company shall maintain a trust balance in an amount greater than or equal to 104% of the liabilities of Arch Reinsurance Ltd. attributable to the reinsurance treaty or treaties with the company.
b. The cash and invested assets in any reinsurance credit trust established by Arch Reinsurance Ltd. on behalf of the company are invested in a manner which complies with ch. 620, Wis. Stat., and s. Ins 6.20, Wis. Adm. Code.
c. The shareholders equity of Arch Reinsurance Ltd., as adjusted based on accounting practices and procedures prescribed by the Commissioner for this adjustment, exceeds the security surplus standard of s. 623.12, Wis. Stat., and s. Ins 51.80, Wis. Adm. Code.
d. The reserves established by Arch Reinsurance Ltd. are equal in all instances to the reserves ceded to Arch Reinsurance Ltd. reflected on the books and records of the company.

3. The company shall obtain and file the following documents with the Commissioner of Insurance with regard to Arch Reinsurance Ltd.:
   a. Any amendment or replacement of any trust agreement that establishes a reinsurance credit trust on behalf of the company, not less than 30 days prior to the proposed effective date.
   b. Annual financial statements prepared in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP) and audited in accordance with the auditing standards generally accepted in the United States of America, by June 1 of each year for the previous calendar year. The company shall prepare an adjustment of the GAAP financial statements based on accounting practices prescribed by the Commissioner for this adjustment. Each report made pursuant to this paragraph is privileged under s. 601.465, Wis. Stat.
   c. Unaudited GAAP financial statements by March 1 of each calendar year end and within 45 days after each interim calendar quarter. The company shall prepare an adjustment of the GAAP financial statements based on accounting practices and procedures prescribed by the Commissioner for this adjustment. Each report made pursuant to this paragraph is privileged under s. 601.465, Wis. Stat.
   d. A copy of the trustee's quarterly report of the financial position and activity of any reinsurance credit trust established by Arch Reinsurance Ltd. for the benefit of the company, including an itemized list of assets, by March 1 each calendar year end and within 45 days after end of each interim calendar quarter.
   e. At the Commissioner's request, provide copies of ceding and retrocession reinsurance agreements to which Arch Reinsurance Ltd. is party.
4. The company's compulsory surplus shall be the greater of:
   a. $2,000,000; or
   b. the sum of:
      (i) An amount equal to fifty percent (50%) of net premiums written for medical malpractice and medical liability insurance in the preceding twelve calendar months; and
      (ii) An amount equal to twenty percent (20%) of net premiums written for all other covered lines of insurance in the preceding twelve calendar months.
5. The company shall maintain surplus in excess of its security surplus standard pursuant to s. 623.12, Wis. Stat., and s. Ins. 51.80(4), Wis. Adm. Code.

6. The company shall maintain a ratio of total adjusted capital to authorized control level risk-based capital of not less than 275%.
7. The company shall maintain a ratio of gross premiums written to surplus of less than 900%.
8. The company shall not waive any run off provision pursuant to the terms of any reinsurance agreement with an affiliate without prior written consent of the Commissioner.
9. The company will be deemed a new insurer from the date it is acquired by Arch Capital Group, Ltd., for the purposes of the application of ss. 611.28 and 617.22, Wis. Stat.
10. The company shall retain an appointed actuary to opine upon the gross and net reserves reported in its statutory annual statement, and this appointed actuary shall send a copy of his complete actuarial report in support of his opinion to the Commissioner by each April 1st for the preceding calendar year.
11. The company will file each contract with any nonaffiliated investment manager and each securities safekeeping agreement with any bank with the Commissioner for the first twelve months following its acquisition by Arch Capital Group, Ltd.
12. For purposes of this Stipulation and Order, the application of the Wisconsin Statutes and the Wisconsin Administrative Code are not modified except as explicitly stated in the order.
13. Any report provided to the Commissioner or demanded by the Commissioner pursuant to this Stipulation and Order shall be required under s. 601.42, Wis. Stat., and under this Stipulation and Order.
14. The company shall comply with all agreements made in this Stipulation and Order.
15. This Order shall continue until modified or rescinded by the Commissioner, with written notice to the company.

In 2003, the company wrote direct premium in the following states:

California	$185,035,897	27.6%
New York	67,491,661	10.1
Texas	52,553,917	7.9
Florida	44,050,758	6.6
Illinois	32,014,637	4.8
New Jersey	31,883,500	4.7
Ohio	20,026,672	3.0
Georgia	17,826,619	2.7
Minnesota	16,441,689	2.4
All others	202,518,941	30.2
Total	$669,844,291	100.0%

The company is only licensed in Wisconsin and is a surplus lines writer approved in the District of Columbia, Puerto Rico, the U.S. Virgin Islands and all other states except New Mexico.

The company writes specialty lines of business through six profit centers as further described below.

The Casualty profit center is comprised of two subdivisions: Primary and Excess. Primary Casualty writes general liability and products liability coverage for a variety of classes. The main concentration is on commercial and residential contracting, commercial and residential premises risks and manufacturing/products risks. Excess Casualty writes both lead umbrellas and excess umbrellas up to $25 million in capacity. The principal areas of focus are commercial contracting, manufacturing, small municipalities, service industries, and both commercial and residential premises risks. Casualty is marketed primarily through wholesale brokers. Property consists of global risks with up to $50 million in capacity. Property risks are written through both retail and wholesale brokers.

Executive Assurance writes commercial accounts (concentrating on Fortune 2000 companies), emerging markets (non-tech public companies with less than $350 million in revenues, private companies, nonprofit companies and public technology and biotechnology companies with less than $1 billion in market capital) and financial institutions (e.g., banking, insurance and registered money management industries). Executive Assurance is marketed through both retail and wholesale broker relationships.

Health care includes large health care accounts, consisting primarily of hospitals and health systems, miscellaneous facilities, which is a diverse classification of risks providing outpatient health care services, and at least one health care program. Large health care is written mainly through retail brokers and miscellaneous facilities business is written mainly through wholesale brokers.

Professional liability includes coverage for large law firms and large accounting firms, miscellaneous professional liability [consisting of coverage for middle market and larger “near” or quasi-professions (e.g., large real estate and insurance brokerage firms, but excluding the traditional professions, such as lawyers, accountants, architects, engineers, and health care professionals)], captive agents professional liability for P&C and life agents of insurance companies with large, captive or semi-exclusive agency forces, brokers-dealers associated with life insurance companies, and design liability which focuses on professional liability for architects, engineers, and construction managers. Professional liability is also comprised of environmental liability, which focuses on fixed-site pollution coverage, professional liability for environmental professionals and contractor's pollution liability. Large law and accounting firms and programs are written through an open brokerage basis. Miscellaneous professional liability and captive agents are written through an open brokerage basis. Design, environmental and accident and health liability are written primarily under programs through large producers (Managing General Underwriters or MGU's).

Construction and surety business includes excess and umbrella coverage for large accounts. Business is developed through a limited number of retail and wholesale brokers.

The following table is a summary of the net insurance premiums written by the company in 2003. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	$101,317,865	$18,893,710	$114,330,902	$ 5,880,673
Allied lines	14,483,249	2,112,882	15,746,592	849,539
Commercial multiple peril	2,009,519		914,337	1,095,182
Inland marine	491,054		74,453	416,601
Medical malpractice - claims made	72,604,949	1,512,500	70,598,446	3,519,003
Earthquake	1,399,103	184,370	1,449,842	133,631
Other liability - occurrence	302,043,724		269,140,189	32,903,535
Other liability - claims made	167,902,896		141,251,439	26,651,457
Products liability - occurrence	38,665,468		35,875,224	2,790,244
Commercial auto liability	(32,897,638)		(31,456,954)	(1,440,684)
Auto physical damage	438,364		77,432	360,932
Fidelity	8,532		7,993	539
Burglary and theft	314,934		24,033	290,901
Boiler and machinery	337,637	5,263	314,694	28,206
Credit	680,728			680,728
Other Warranty	43,903			43,903
Total All Lines	$669,844,287	$22,708,725	$618,348,622	$74,204,390

Commercial auto liability premium is negative because the company classified the business incorrectly in 2002. They discovered this in 2003 and corrected the classification for both years in 2003. The company has developed a database which should help eliminate such errors in the future.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of seven members. These directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive no compensation for serving on the board, other than their normal salaries.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Ralph E. Jones III West Simsbury, Connecticut	President and CEO, Arch Insurance Group Inc.	2005
Mark D. Lyons Deer Park, Illinois	Executive Vice President, Ins. Group Operations & Chief Actuary Arch Insurance Group Inc.	2005
Martin J. Nilsen Rockville Centre, New York	Senior Vice President, Secretary and General Counsel Arch Insurance Group Inc.	2005
Thomas G. Kaiser Highlands, New Jersey	Executive Vice Pres. & President Marine, Property, Energy & Aviation Division Arch Insurance Group Inc.	2005
Fred S. Eichler New York, New York	Senior Vice President, Chief Financial Officer Arch Insurance Group Inc.	2005
Ellen H. Darrigrand Dunwoody, Georgia	Executive Vice President & CAO Arch Insurance Group Inc.	2005
Elaine A. Trischetta New York, New York	Executive Vice President, Casualty Division Arch Insurance Group Inc.	2005

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2003 Compensation
Ralph E. Jones III	President and CEO	$ 816,995*
Thomas G. Kaiser	President, Property, Energy and Marine	1,308,501
Mark Lyons	Executive Vice President, Ins. Group Operations & Chief Actuary	876,494
Elaine A. Trischetta	Executive Vice President, Casualty Division	825,310
Thomas L Gamble	Executive Vice President, Executive Assurance Division	695,191
Michael R. Murphy	Executive Vice President, Professional Liability Division	736,604
John P. Mentz	Executive Vice President, Construction & Surety Division	579,116
Steven D. Nelson	Executive Vice President, Healthcare Division	
David G. May**	Executive Vice President, Lenders & Alternative Markets Division	627,124
Mark G. Wade	Executive Vice President, Claims Division	599,513
Ellen H. Darrigrand	Executive Vice President, Southeast Region	547,284
Thomas McMahon	Executive Vice President, Northeast Region	268,346*
William Palmer	Executive Vice President, Midwest Region	241,930
Fred S. Eichler	Senior Vice President & Chief Financial Officer	239,057*
Martin J. Nilsen	Senior Vice President, Secretary & General Counsel	300,892
Ramin Taraz	Vice President & Controller	254,574

* The amount reflects the estimated annual compensation rather than the actual, which is not a full year's compensation. Amount shown include bonuses when applicable; Arch group requires an officer to work a full calendar year to be eligible for a bonus, so some amounts do not include bonuses.

** Resigned effective March 31, 2005.

Amounts reported are total compensation by Arch Insurance Group Inc. and are allocated to affiliates; Arch Specialty's share was 49%.

Committees of the Board

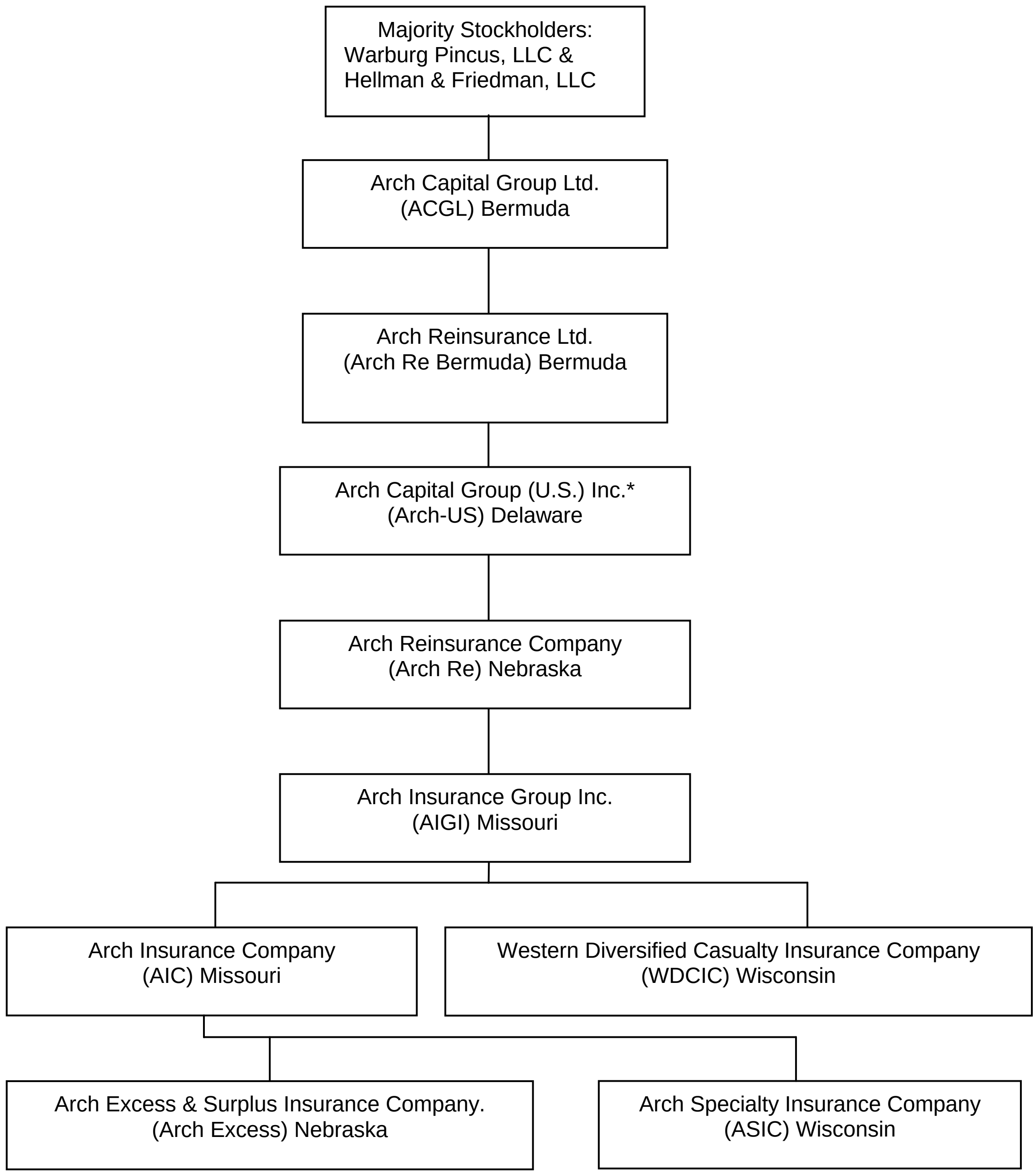
The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
Ralph E. Jones III, Chair
Mark D. Lyons
Fred S. Eichler
Martin J. Nilsen

IV. AFFILIATED COMPANIES

Arch Specialty is a member of a holding company system ultimately owned by Arch Capital Group Ltd., a Bermuda public limited liability company (hereinafter the "Arch holding company system"). Investment funds associated with Warburg Pincus LLC and Hellman & Friedman LLC own a majority of ACGL outstanding shares, and are also deemed to be controlling parties. Due to the size and complexity of the corporate interests of the Arch Capital Group, this report will confine its discussion to affiliated companies that have a direct relationship through shared services or other agreements with Arch Specialty. The organizational chart below depicts the applicable portion of the holding company system defined above. A brief description of the significant affiliates follows the organizational chart.

Organizational Chart
As of December 31, 2003



*Arch-US is owned 86.6% by Arch Re Ltd. and 13.4% owned by Alternative Re Ltd., another affiliate.

Majority Stockholders

Investment funds affiliated with Warburg Pincus LLC and Hellman & Friedman LLC together own a majority of ACGL's outstanding voting shares and have the right to have directors on ACGL's board and to approve most transactions outside of the ordinary course of business.

Arch Capital Group Ltd.

Arch Capital Group Ltd. (ACGL) is a Bermuda public limited liability company. ACGL provides insurance and reinsurance on a worldwide basis through its wholly owned subsidiaries. ACGL's common shares are traded on the NASDAQ National Market under the symbol ACGL. As of December 31, 2003, the Annual Report indicated assets of $5.585 billion, liabilities of $3.874 billion, and shareholder equity of $1.711 billion. Operations for 2003 produced net income of $281 million.

Arch Reinsurance Ltd.

Arch Reinsurance Ltd. (Arch Re Bermuda) is a Bermuda-based reinsurer that was incorporated in May 2001 in Bermuda and is a wholly owned subsidiary of ACGL. Arch Re Bermuda is licensed in Bermuda to underwrite both general and long-term business on an insurance and reinsurance basis. The company is engaged in underwriting general business only. As of December 31, 2003, the company reported audited non-consolidated GAAP assets of $4.268 billion, liabilities of $2.461 billion, and surplus of $1.807 billion. Operations for 2003 produced net income of $297 million.

Arch Capital Group (U.S.) Inc.

Arch Capital Group (U.S.) Inc. (Arch-US) was incorporated on March 25, 1995, as a Delaware-domiciled holding company. Arch-US is a subsidiary of Arch Re Bermuda. It has no employees. It is the direct parent of Arch Re. Arch-US reported, as of December 31, 2003, unaudited consolidated GAAP assets of $3.310 billion, liabilities of $2.829 billion, and stockholders equity of $481 million. Operations for 2003 produced net income of $32 million.

Arch Reinsurance Company

Arch Reinsurance Company (Arch Re) is a Nebraska-domiciled reinsurance company, which received its license on November 6, 1995, and is currently licensed as a reinsurer in 45 states and the District of Columbia and is accredited in the remaining five states. The company is a wholly owned subsidiary of Arch-US. Arch Re provides property and casualty reinsurance and other forms of capital, either on a stand-alone basis or as part of integrated capital solutions, for insurance companies with capital needs which could not be met by reinsurance alone. As of December 31, 2003, Arch Re reported statutory assets of $718 million, liabilities of $335 million, and surplus of $383 million. Operations for 2003 produced net income of $29 million.

Arch Insurance Group Inc.

Arch Insurance Group Inc. (AIGI) was formed in May of 1971 as a Missouri-domiciled holding company. In 2004, AIGI redomiciled to Delaware. AIGI is a holding company whose employees provide services to affiliates, including Arch Specialty. AIGI is the parent of several affiliates including Arch Specialty's parent, Arch Insurance Company. AIGI reported, as of December 31, 2003, unaudited consolidated GAAP assets of $2.171 billion, liabilities of $1.870 billion, and shareholders equity of $301 million. Operations for 2003 produced a net income of $4.6 million.

Arch Insurance Company

Arch Insurance Company (AIC) provides a wide range of property and casualty insurance to businesses and professional firms nationwide. AIC is domiciled in Missouri and holds licenses in all 50 states, the District of Columbia, and Puerto Rico. The 2003 statutory annual statement reports assets of $651 million, liabilities of $402 million, and policyholders' surplus of $249 million. Operations for 2003 produced a net loss of $1.4 million.

Western Diversified Casualty Insurance Company

Western Diversified Casualty Insurance Company (WDCIC) is currently inactive. Arch management intends to use the company to write business in states in which it is licensed. The company is licensed in all states and the District of Columbia except Connecticut, New Jersey, New York, and Vermont. As of December 31, 2003, the statutory financial statements of WDCIC reported assets of $10 million, immaterial liabilities, and capital and surplus of $10 million. Operations for 2003 produced net income of $251,000.

Arch Excess & Surplus Insurance Company

Arch Excess & Surplus Insurance Company (Arch Excess) provides a wide range of excess and surplus lines property and casualty insurance for businesses and professional firms. The company is domiciled in Nebraska and is approved to write excess and surplus lines insurance in 41 states and the District of Columbia. The 2003 statutory annual statement reports assets of $27.6 million, liabilities of $5.0 million, and policyholders' surplus of $22.6 million. Operations for 2003 produced a net profit of $1.3 million.

Agreements with Affiliates

Tax-Sharing Agreement

The company participates in a Tax-Sharing Agreement with its upstream parent, Arch-US, and other affiliated companies. Arch-US assumes responsibility for preparing the tax returns and is reimbursed by its subsidiaries, including the company. Tax is computed as if each subsidiary is on a stand-alone basis. Payments are due before the end of the calendar month in which the parent paid the tax.

Equipment Cost Allocation Agreement

This is an agreement to spread the depreciation cost of equipment owned by AIC. The depreciation is allocated by the direct premiums written by each subsidiary to the total direct premium written by all subsidiaries. This agreement became effective June 1, 2004. Payment is due within 30 days after each quarterly billing.

Administrative Service Agreement

This agreement calls for AIGI to provide underwriting, actuarial, claims, accounting, data processing and systems work, and to keep records and statistics for the company. The expenses incurred by AIGI on behalf of the company are billed at any time throughout the month with payment due by the last business day of the following month.

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The company uses reinsurance brokers to negotiate some of its contracts. The contracts contained proper insolvency provisions.

Affiliated Ceding Contracts

1. Type: 90% Quota Share Reinsurance

   Reinsurer: Arch Reinsurance Ltd. (Bermuda Affiliate)

   Trust agreement: There is a trust agreement for the benefit of the company in an amount equal to 104% of the reinsurer's obligation to the company, pursuant to the Stipulation and Order discussed earlier in this report.

   Scope: All business written except business produced by the reinsured's alternative market business profit centers or its lenders' products policies or programs, and in the case of the reinsured's program business profit centers, programs that first incept or renew during the term hereof.

   Effective date: January 1, 2003

   Termination: By either party with 365 days prior written notice. In addition, special provisions exist in the event of either party becoming insolvent or otherwise financially impaired.

   Retention: 10% of its net retained liability

   Coverage: 90% of its net retained liability with stated exclusions

   Premium: 90% of the net written premium

   Commissions: 28.5% of the net written premium adjusted annually, on a retroactive basis, by a transfer pricing analysis. In 2004, the transfer pricing analysis reduced the ceding commission by 0.5%

Nonaffiliated Ceding Contracts

1. Type: Umbrella & Excess Casualty - Quota Share

   Cedants: Arch Insurance Company, Arch Specialty Insurance Company, Arch Excess & Surplus Insurance Company, Western Diversified Casualty Insurance Company, and/or any other subsidiaries or affiliates of the Arch Insurance Group Inc. including any and/or all companies that are or may hereafter become affiliated therewith.

Reinsurer:	Ace Prop. & Cas. Ins Co.	12%
	Swiss Reinsurance Co.	12
	Odyssey American Reinsurance	10
	Berkley Insurance Co.	10
	Liberty Mutual Insurance Co.	8
	Subtotal	52%
	Arch Reins. Co. (Nebraska affiliate)	8
	Total All Participants	60%

Effective date:	May 1, 2004
Termination:	April 30, 2005. In addition, special provisions allow for an accelerated termination initiated by the company in the event of insolvency or financial stress of any of the Reinsureds.
Scope:	Business classified by the company as umbrella liability and following form excess liability, with stated exclusions.
Retention:	40% quota share participation of the first $25,000,000 of net loss, each and every risk, each and every incident, accident, occurrence or claim made, plus 40% of extra contractual obligations and loss in excess of the policy limits up to one additional policy limit each risk, each and every incident, accident, occurrence or claim made.
Coverage:	60% quota share participation of the first $25,000,000 of net loss, each and every risk, each and every incident, accident, occurrence or claim made, plus 60% of extra contractual obligations and loss in excess of the policy limits up to one additional policy limit each risk, each and every incident, accident, occurrence or claim made. The Reinsurers' aggregate limit of liability for all losses that result directly from Acts of Terrorism, as defined by the treaty, is limited to $30,000,000, which constitutes their 60% pro rata share of $50,000,000 in the aggregate.
Premium:	Each Reinsurer's proportionate share of the net subject written premium.
Commissions:	Original commission plus 12.5% not to exceed 27.5% of ceded Original Gross Net Written Premium Income on all business other than if there is a commission incentive arrangement in place which will be on a flat 27.5% ceding commission to be adjusted within the monthly report.
Other provisions:	The Reinsured is obligated to retain its 40% pro rata share of retained risk without benefit of any third-party unaffiliated reinsurance. The Reinsured is free to cede its retention to affiliates through inter-group pooling or other reinsurance arrangements.

2. Type: Property Energy - Quota Share

Cedants:	Arch Insurance Company, Arch Specialty Insurance Company, Arch Excess & Surplus Insurance Company, Western Diversified Casualty Insurance Company, and/or any other subsidiaries or affiliates of Arch Insurance Group Inc. including any and/or all companies that are or may hereafter become affiliated.

Reinsurer:

Swiss Reinsurance America Corp.	10.25%
Everest Reinsurance Co.	13.00
Endurance Specialty Ins. Ltd.	11.50
Federal Ins. Co.	5.00
XL Reinsurance America Inc.	4.00
Transatlantic Reinsurance Co.	4.00
Aspen Ins. UK Ltd.	2.25
Total	50.00%

Effective date:	December 31, 2003
Termination:	By either party with 90 days prior written notice by certified mail. In addition, special provisions exist in the event of either party becoming insolvent or a change in ownership.
Scope:	New and renewal business, including assumed reinsurance, underwritten or approved by the company's Energy Division, as Property Risks, including both Boiler & Machinery, Builders Risk, and the following technical risks classified by the company as: Oil and Petrochemical, Chemical, Power Generation, Pulp and Paper, Steel, Mining, and Construction All Risk/Erection All risk, with stated exclusions.
Retention:	50% of the company's net liability for each occurrence, each risk, of up to and including $50,000,000.
Coverage:	50% of the ultimate net liabilities subject to a maximum cession limit of $50,000,000 each risk. This Quota Share is further subject to a maximum occurrence limitation of $90,000,000 per occurrence.
Premium:	Each Reinsurer's proportionate share of the net subject written premium.
Commissions:	26% of the subject net written premium

3. Type: Property Excess and Surplus - Quota Share

Cedants:	Arch Insurance Company, Arch Specialty Insurance Company and Arch Excess & Surplus Insurance Company

Reinsurer:

Employers Reinsurance Corp.	15.00%
Endurance Specialty Ins. Ltd.	11.50
Platinum Underwriters Reins., Inc.	10.00
GE Reinsurance Corp.	7.50
QBE Reinsurance Corp.	5.00
Mapfre Reinsurance Corp.	2.50
Total	51.50%

Effective date:	November 1, 2003
Termination:	Any November 1 by either party with at least 90 calendar days prior written notice by certified mail or registered mail. In addition, special provisions allow for an accelerated termination initiated by the company in the event of insolvency or financial stress of any of the Reinsured's.
Scope:	Business written by the company's Excess and Surplus Lines Division and classified by the company as Property Business with stated exclusions.
Retention:	48.5% of the company's net liability for each loss, each risk, of up to and including $10,000,000 plus each Reinsured's proportionate share of loss expenses.
Coverage:	51.5% of the ultimate net liabilities subject to a maximum cession limit of $10,000,000 each risk. This Quota Share is further subject to a maximum loss occurrence, as defined in the contract, limitation of greater of $100,000,000 per loss occurrence or 200% of the gross net written premium subject to a maximum of $150,000,000.
Premium:	Each Reinsurer's proportionate share of the net subject written premium.
Commissions:	Sliding scale contingent commission based on the profitability of the underlying business with a minimum commission of 27.5% adjusted to a maximum commission of 35%.

4. Type: Property Excess and Surplus - Per Risk Excess of Loss

Cedants:	Arch Insurance Company, Arch Specialty Insurance Company, Arch Excess & Surplus Insurance Company, and the Quota Share Reinsurers as noted in contract 3 above.
Reinsurer:	Various See Exhibit A at the end of this section
Effective date:	November 1, 2003 (Second Excess is effective September 15, 2003)
Termination:	November 1, 2004. In addition, special provisions allow for an accelerated termination initiated by the company in the event of insolvency or financial stress of any of the Reinsured's.
Scope:	Business classified as property underwritten by the company's excess and surplus lines division.

Coverage:

	First Excess	Second Excess	Third Excess
Retention	$ 2,500,000	$10,000,000	$25,000,000
Per Risk Limit	7,500,000	15,000,000	25,000,000
Per Occurrence Limit	25,000,000	30,000,000	25,000,000
Annual Limit	45,000,000	45,000,000	50,000,000

Reinstatement:	a. First Excess Five full reinstatements at no charge. b. Second Excess One full reinstatement at no charge with an additional reinstatement available calculated pro rata as to amount and 100% to time. c. Third Excess One full reinstatement available calculated pro rata as to amount and 100% to time.
Premium:	Net Written Premium times a factor, with required minimum premium. Deposit premiums are required and must be paid in quarterly installments.

	First Excess	Second Excess	Third Excess
Premium Factor	15.0%	4.5%	2.0%
Minimum Premium	$ 9,000,000	$3,150,000	$1,200,000
Deposit Premium	11,250,000	3,937,000	1,500,000

5.	Type:	Executive Assurance - Quota Share
	Cedants:	Arch Insurance Company and Arch Specialty Insurance Company
	Reinsurer:	Employers Reinsurance Corporation
	Effective date:	April 1, 2002
	Termination:	By either party with 180 days prior written notice (or 90 days' notice upon discovery by a party hereto of any illegal or unethical act) by registered or overnight delivery service mail, stating the termination date. In addition, special provisions exist in the event of any court-determined insolvency or financial impairment.
	Scope:	Directors and Officers Liability and Other Professional Liability Coverage's as stated within the contract.
	Retention:	50% of the net retained liability
	Coverage:	50% of the net retained liability limited to a $10,000,000 aggregate per product line per insured limit
	Premium:	50% of the subject net written premium
	Commissions:	29.5% of the subject reinsurance premium
6.	Type:	Property - Catastrophe Excess of Loss
	Cedants:	Arch Insurance Company, Arch Specialty Insurance Company, Arch Excess & Surplus Insurance Company, Western Diversified Casualty Insurance Company, and/or any other subsidiaries or affiliates of Arch Insurance Group Inc. including any and/or all companies that are or may hereafter become affiliated

Reinsurer:	Various See Exhibit B at the end of this section
Effective date:	January 1, 2004
Termination:	January 1, 2005
Scope:	Business classified as property excluding marine with stated exclusions

Coverage (95% placed):

	First Excess	Second Excess	Third Excess
Retention*	$50,000,000	$70,000,000	$105,000,000
Limit	20,000,000	35,000,000	55,000,000
Annual Limit	40,000,000	70,000,000	110,000,000

*Company retains 5% of covered losses in addition to base retention

Premium: Net Earned Premium times a factor, with required minimum premium. Deposit premiums are required and must be paid in quarterly installments on January 1, April 1, July 1 and October 1

	First Excess	Second Excess	Third Excess
Premium Factor	2.7399%	2.8768%	2.7985%
Minimum Premium	$2,800,000	$2,940,000	$2,860,000
Deposit Premium	3,500,000	3,675,000	3,575,000

Nonaffiliated Facultative Contracts

The company assumes specific risks on a facultative basis from over fifty unaffiliated U.S. and non-U.S. entities. In 2003, the company assumed a total of approximately $22.4 million related to this business.

Exhibit A
Property Excess and Surplus Per Risk Excess of Loss
Participation Schedule

Reinsurer	Participation First Excess	Participation Second Excess	Participation Third Excess
Allied World Assurance Co. Ltd.	18.50%	8.67%	0.00%
Aspen Ins. UK Ltd.	0.00	6.34	11.21
Employers Reinsurance Corp.	10.00	0.00	5.00
Endurance Specialty Ins. Ltd.	0.00	9.50	2.00
Hannover Ruckversicherungs-Aktiengesellschaft	10.00	7.00	5.00
GE Frankona Reinsurance Ltd.	0.00	0.00	2.24
GE Reinsurance Corp.	0.00	0.00	2.50
Liberty Mutual Ins. Co.	7.00	0.00	0.00
Mapfre Reinsurance Corp.	2.50	2.66	2.50
Montpelier Reinsurance Ltd.	12.00	0.00	0.00
Partner Reinsurance Co. of the U.S.	20.00	6.00	0.00
Platinum Underwriters Reins. Inc.	0.00	12.50	10.00
QBE Reinsurance Corp.	0.00	2.67	5.00
XL Reinsurance America Inc.	10.00	0.00	0.00
XL Re Ltd.	5.00	0.00	0.00
Underwriters at Lloyd's	5.00	18.00	34.55
Total Placement	100.00%	73.34%	80.00%

Exhibit B
Property Catastrophe Excess of Loss Reinsurance
Participation Schedule

Reinsurer	**First Excess**	**Participation Second Excess**	**Third Excess**
American Agriculture Ins. Inc.	2.0000%	0.6367%	0.6180%
American Re-Insurance Co.	0.0000	4.7753	4.6350
GE Reinsurance Corp.	5.0000	3.1835	3.6900
Liberty Mutual Ins. Co.	0.7000	0.4457	0.4326
Mapfre Reinsurance Corp.	0.0000	2.2285	4.8500
Platinum Underwriters Reins. Inc.	0.0000	6.3667	9.5000
QBE Reinsurance Corp.	0.0000	0.0000	1.2360
Axis Specialty Ltd.	20.0000	3.1835	3.0900
Endurance Specialty Ins. Ltd.	4.0000	4.7753	6.4150
Hannover Re (Bermuda) Ltd.	10.0000	4.2853	2.7275
Montpelier Reinsurance Ltd.	4.7250	4.7753	4.6350
PXRE Reinsurance Ltd.	7.5000	4.1386	3.7300
Munchener Ruckversicherungs-Gesellschaft	0.0000	6.3670	6.1800
Sirius International Ins. Corp. (PUBL)	0.0000	0.6367	1.4000
Swiss Reinsurance America Corp.	0.0000	3.1835	3.0900
GE Frankona Reinsurance Ltd.	5.0000	4.7706	4.6339
Wellington Reinsurance Ltd.	9.5750	11.5500	7.3500
ALEA London Ltd.	5.0000	1.5000	1.7500
Underwriters at Lloyd’s	21.5000	28.1978	25.0370
Total Placement	95.0000%	95.0000%	95.0000%

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Arch Specialty Insurance Company
Assets
As of December 31, 2003

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$224,637,345	$	$224,637,345
Cash	17,023,592		17,023,592
Short-term investments	10,290,704		10,290,704
Investment income due and accrued	2,858,682		2,858,682
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	31,327,347	2,092,770	29,234,577
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	4,578,716		4,578,716
Reinsurance:			
Amounts recoverable from reinsurers	12,861,009		12,861,009
Current federal and foreign income tax recoverable and interest thereon	1,034,711		1,034,711
Net deferred tax asset	11,825,334	6,491,210	5,334,124
Receivable from parent, subsidiaries, and affiliates	11,592,235		11,592,235
Other assets nonadmitted	196,191	196,191	0
Aggregate write-ins for other than invested assets:			
Advance claim payments	940,792		940,792
Claim deposit	147,942		147,942
Total Assets	$329,314,600	$8,780,171	$320,534,429

Arch Specialty Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2003

Losses		$ 34,997,307
Loss adjustment expenses		21,553,465
Commissions payable, contingent commissions, and other similar charges		3,858,299
Other expenses (excluding taxes, licenses, and fees)		30,546
Taxes, licenses, and fees (excluding federal and foreign income taxes)		16,684
Unearned premiums		26,617,565
Ceded reinsurance premiums payable (net of ceding commissions)		76,124,933
Provision for reinsurance		224,549
Payable to parent, subsidiaries, and affiliates		6,762,236
Write-ins for liabilities:		
Deferred ceding commission liability		18,847,000
Net insurance balances payable to SIAMCO		11,565,279
Unapplied cash		5,035,611
Return premium payable		3,901,060
Other liabilities		79,476
Total Liabilities		209,614,010
Common capital stock	$ 4,200,000	
Gross paid in and contributed surplus	98,712,226	
Unassigned funds (surplus)	8,008,193	
Surplus as Regards Policyholders		110,920,419
Total Liabilities and Surplus		$320,534,429

Arch Specialty Insurance Company
Summary of Operations
For the Year 2003

Underwriting Income		
Premiums earned		$67,817,881
Deductions:		
Losses incurred	$31,910,422	
Loss expenses incurred	22,885,035	
Other underwriting expenses incurred	5,570,049	
Total underwriting deductions		60,365,506
Net underwriting gain		7,452,375
Investment Income		
Net investment income earned	4,879,479	
Net realized capital gains	641,063	
Net investment gain		5,520,542
Net income before dividends to policyholders and before federal and foreign income taxes		12,972,917
Federal and foreign income taxes incurred		11,643,912
Net Income		$ 1,329,005

Arch Specialty Insurance Company
Cash Flow
For the Year 2003

Premiums collected net of reinsurance			$ 72,426,999
Net investment income			4,819,813
Total			77,246,812
Benefit and loss related payments		$ (7,302,750)	
Commissions, expenses paid, and aggregate write-ins for deductions		(6,022,788)	
Federal and foreign income taxes paid		12,678,623	
Total deductions			(646,915)
Net cash from operations			77,893,727
Proceeds from investments sold, matured, or repaid:			
Bonds		194,291,138	
Cost of investments acquired (long-term only):			
Bonds	$307,456,138		
Miscellaneous applications	15,320,573		
Total investments acquired		322,776,711	
Net cash from investments			(128,485,573)
Cash from financing and miscellaneous sources:			
Capital and paid in surplus less treasury stock		61,034,227	
Other cash provided (applied)		(24,159,120)	
Net cash from financing and miscellaneous sources			36,875,107
Reconciliation			
Net change in cash and short-term investments			(13,716,739)
Cash and short-term investments, December 31, 2002			41,031,035
Cash and short-term investments, December 31, 2003			$ 27,314,296

Arch Specialty Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2003

Assets		$320,534,429
Less liabilities		209,614,010
Adjusted surplus		110,920,419
Annual premium:		
Lines other than accident and health	$74,204,390	
Factor	20%	
Compulsory surplus (subject to a minimum of $2 million)		14,840,878
Compulsory surplus excess (or deficit)		$ 96,079,541
Adjusted surplus (from above)		$110,920,419
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		20,628,820
Security surplus excess (or deficit)		$ 90,291,599

Arch Specialty Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2003	**2002**	**2001**	**2000**	**1999**
Surplus, beginning of year	$ 50,161,561	$18,095,460	$17,368,324	$16,341,664	$40,493,841
Net income	1,329,005	1,673,508	727,136	1,026,660	5,985,257
Net unrealized capital gains or (losses)					910,340
Change in net deferred income tax	7,775,047	1,695,287	47,295		
Change in non-admitted assets	(4,873,194)	(3,906,977)			
Change in provision for reinsurance	(132,227)	(92,322)			
Cumulative effect of changes in accounting principles			(47,295)		
Capital changes:					
Paid in					
Surplus adjustments:					
Paid in	61,034,227	34,615,437			1,100,000
Net remittances from or (to) home office					
Dividends to stockholders		(1,918,832)			(32,678,146)
Write-ins for gains and (losses) in surplus:					
Prior year audit adjustment	(4,374,000)				
Change in excess of statutory reserves over statement reserves					530,372
Surplus, end of year	$110,920,419	$50,161,561	$18,095,460	$17,368,324	$16,341,664

Arch Specialty Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2003

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	**2003**	**2002**	**2001**	**2000**	**1999**
#1	Gross Premium to Surplus	624.0%	439.0%	16.0%	92.0%	137.0%
#2	Net Premium to Surplus	67.0	57.0	0.0	0.0	64.0
#3	Change in Net Writings	161.0*	999.0*	0.0	(99.0)*	(65.0)*
#4	Surplus Aid to Surplus	21.0*	21.0*	1.0	12.0	11.0
#5	Two-Year Overall Operating Ratio	76.0	39.0	0.0	97.0	98.0
#6	Investment Yield	2.4*	2.7*	6.2	7.2	10.6*
#7	Change in Surplus	121.0*	177.0*	4.0	6.0	(62.0)*
#8	Liabilities to Liquid Assets	80.0	83.0	48.0	16.0	14.0
#9	Agents' Balances to Surplus	26.0	43.0*	1.0	0.0	0.0
#10	One-Year Reserve Development to Surplus	(3.0)	0.0	0.0	0.0	(3.0)
#11	Two-Year Reserve Development to Surplus	0.0	0.0	0.0	(3.0)	(3.0)
#12	Estimated Current Reserve Deficiency to Surplus	0.0	0.0	0.0	0.0	153.0*

This examination will comment on the unusual ratios since the company was acquired by Arch Capital Group Ltd. in 2002.

Ratio number 3 is the percentage change in net writings. These unusual ratios were due to the company being acquired and starting to write business.

Ratio number 4 is Surplus Aid to Surplus. The unusual ratios can be attributed to the quota share agreement with an affiliate and the company writing business.

Ratio number 6 calculates the investment yield of the company. The unusual ratios are due to the company investing mostly in bonds and the current low interest rates in the bond market. In addition, within the bonds owned by the company 38.4% are in U.S. Treasuries and Municipal/Special Revenue bonds.

Ratio number 7, change in surplus, is unusual due to two capital contributions made in 2002 and 2003.

Ratio number 9, agents' balances to surplus, was due to the company beginning to write business.

Growth of Arch Specialty Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2003	$320,534,429	$209,614,010	$110,920,419	$1,329,005
2002	182,337,775	132,176,214	50,161,561	1,673,508
2001	25,910,631	7,815,170	18,095,461	727,136
2000	18,422,225	1,053,899	17,368,326	1,026,660
1999	19,650,039	3,308,375	16,341,664	5,985,257
1998	92,720,979	52,227,138	40,493,841	521,728

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2003	$692,553,012	$74,204,390	$67,817,881	80.8%	7.5%	88.3%
2002	220,302,269	28,379,492	8,148,437	84.1	(3.7)	80.4
2001	2,959,352	0	0	0	0	0
2000	16,030,929	0	0	0	0	0
1999	22,454,812	10,521,881	23,753,588	83.8	40.3	124.1
1998	37,537,651	29,838,756	29,792,197	89.4	29.1	118.5

Since being acquired by Arch Capital Group Ltd., the company's assets have increased from $25,910,631 (prior to acquisition) in 2001 to $320,534,429 in 2003. Liabilities have increased from $7,815,170 in 2001 to $209,614,010 in 2003. Surplus has increased from $18,095,461 in 2001 to $110,920,419 in 2003. One of the reasons for the surplus increase besides net income is paid in surplus of $34,615,437 in 2002 and $61,034,227 in 2003. Gross, Net and Earned Premiums have increased due to the company writing business under its new business plan after being acquired. The low expense ratios can be attributed to ceding commissions received from ceding 90% of the company's business. The company's business reported very good combined ratios of 80.4% and 88.3% in 2002 and 2003, respectively.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2003 is accepted.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

The company redomesticated to the state of Wisconsin in 2002. The prior examination was conducted by the Illinois Department of Insurance in 1999-2000 as of December 31, 1998. The Illinois examination had five findings in the summary section.

1. The company's surplus was increased by $202k to $40,696k.

2. The company's surety bond was not in compliance with 50 Ill. Adm. Code Part 904.50 a.

3. The company has not completed a Disaster Recovery Plan for its distributed network systems, and a hot site has not been identified and recovery has not been tested under simulated conditions of an Information System disaster at the Moline site.

4. The examiners reviewed the company's custodial agreement and it lacked the following provisions as recommended in the <u>NAIC Financial Examiners Handbook</u>.

5. The company was not in compliance with 215 ILCS 5/126.31 in that the company did not maintain documentation demonstrating that investments were acquired in accordance with the Article VIII (Investment of Domestic Companies) of the Illinois Code and specifying the section of Article VIII under which they were acquired.

Examiners reviewed the prior recommendations during the current examination. Due to the change in domicile and two changes in ownership since the last examination, this report does not indicate compliance or noncompliance with the prior recommendations.

Summary of Current Examination Results

Business Continuity/Disaster Recovery Plans

During the review of the information systems it was noted by the examiner that the company had not completed business continuity or disaster recovery plans for key insurance locations and financially significant insurance operations. During 2004, the company hired a consulting service to assist in establishing a centralized, coordinated company-wide business continuity and disaster recovery plan for all key insurance group locations. The company projects that the plans will be completed by the end of 2004 and expects testing to be conducted shortly thereafter. It is recommended that the company complete its business continuity/disaster recovery plans for key insurance locations and financially significant insurance operations and once completed the plans should be reviewed, updated, and tested on an annual basis.

Custodial Agreement

The majority of the company's securities are held by a bank under a safekeeping agreement. The agreement did not contain satisfactory safeguards and controls as specified in the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. This was a recommendation under the previous ownership. Company management had attempted to correct the language after another state's examination of an affiliate. However, the amended language did not fully address the requirements. It is again recommended that the company amend its safekeeping agreement to include provisions requiring:

- That the custodian is obligated to indemnify the company for any loss of securities of the company in the trust company's custody occasioned by the negligence or dishonesty of the trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction; and
- That, in the event that there is a loss of the securities for which the custodian is obligated to indemnify the company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

Reinsurance

As noted in the section of this report titled "Reinsurance," several of the company's reinsurance contracts are negotiated with the assistance of various reinsurance intermediaries - brokers. Pursuant to s. Ins 47.03, Wis. Adm. Code, reinsurance intermediaries - brokers are required to obtain written authorization or enter into a contract with the insurer that specifies the responsibilities of each party. Required terms include standards related to: financial reporting, recordkeeping, access rights, disclosure requirements, standards for handling the funds and the ability of the insurer to terminate a reinsurance intermediary-broker at any time without cause. The examination noted that the company was not in the practice of providing written authorization or entering into contracts with its reinsurance intermediaries. It is recommended that the company provide written authorization or enter into contracts with all reinsurance intermediaries - brokers used by the company in compliance with s. Ins 47.03, Wis. Adm. Code.

Also, as noted in the section of this report titled "Reinsurance," under a 90% Quota Share Agreement the company cedes the majority of its business to its Bermuda-based indirect parent, Arch Reinsurance Ltd. In 2003, the company also ceded approximately $20 million to its Nebraska-domiciled affiliate, Arch Reinsurance Company. These cessions represent several separate reinsurance contracts that were originally negotiated through various brokers of which Arch Reinsurance Company participated under the same terms and conditions negotiated previously with the unaffiliated reinsurers but Arch Re was never the "lead" reinsurer. Arch Reinsurance decides on its participation in these contracts based on an independent business evaluation of the specific business that is being reinsured. However, the amount of premium ceded to Arch Re for several individual contracts, as well as in aggregate, exceeded 5% of the company's policyholder surplus as of the preceding calendar year, which requires a Form D filing under the holding company regulations (s. Ins 40.04, Wis. Adm. Code). Also, under the Stipulation and Order any affiliate assuming business is to establish a trust account approved by the Commissioner. Therefore, these agreements should have been filed for approval with the Commissioner prior to becoming effective, in compliance with s. 617.21, Wis. Stat., and s. Ins 40.04 (2), Wis. Adm. Code. It is recommended that the company properly file all future affiliated reinsurance agreements, or any amendment thereof, at least 30 days in advance of the effective date, in compliance with s. 617.21, Wis. Stat., and s. Ins 40.04 (2), Wis. Adm. Code. It is also recommended that the company comply with all requirements of the Stipulation and Order including obtaining prior approval and set up a trust for all affiliated reinsurance agreements.

VIII. CONCLUSION

The company was acquired by the Arch Capital Group Ltd. (Bermuda) in 2002. The company had unusual IRIS results due mainly to the company being acquired and starting to write business again. The company's admitted assets, liabilities, and surplus increased significantly since being acquired. The company's combined ratios have been very good for the past two years. The prior exam recommendations were included but not reviewed for compliance due to two changes of ownership since the last examination. The current examination resulted in five recommendations. One concerns business continuity/disaster recovery plans. One concerns the language of the company's custodial agreement. Three involve reinsurance; the first recommendation is on having agreements with insurance intermediaries; one concerns filing of affiliated reinsurance agreements; and the last one concerns having a trust agreement per the Stipulation and Order the company has agreed to.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 35 - Business Continuity/Disaster Recovery Plans—It is recommended that the company complete its business continuity/disaster recovery plans for key insurance locations and financially significant insurance operations and once completed the plans should be reviewed, updated, and tested on an annual basis.

2. Page 35 - Custodial Agreement—It is again recommended that the company amend its safekeeping agreement to include provisions requiring:

   - That the custodian is obligated to indemnify the company for any loss of securities of the company in the trust company's custody occasioned by the negligence or dishonesty of the trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction; and

   - That, in the event that there is a loss of the securities for which the custodian is obligated to indemnify the company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

3. Page 36 - Reinsurance—It is recommended that the company provide written authorization or enter into contracts with all reinsurance intermediaries - brokers used by the company in compliance with s. Ins 47.03, Wis. Adm. Code.

4. Page 36 - Reinsurance—It is recommended that the company properly file all future affiliated reinsurance agreements, or any amendment thereof, at least 30 days in advance of the effective date, in compliance with s. 617.21, Wis. Stat., and s. Ins 40.04 (2), Wis. Adm. Code.

5. Page 37 - Reinsurance—It is also recommended that the company comply with all requirements of the Stipulation and Order including obtaining prior approval and set up a trust for all affiliated reinsurance agreements.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Tim VandeHey	Advanced Examiner-IT Specialist
William C. Genne	Insurance Financial Examiner
Sheur Yang	Insurance Financial Examiner

Respectfully submitted,

David A. Grinnell
Examiner-in-Charge

XI. SUBSEQUENT EVENTS

PSA Agreements

The New York Attorney General started an investigation and has prosecuted some cases regarding placement service agreements (PSAs) between brokers and insurance companies. The charges to date are for alleged bid rigging and client steering. The company was not mentioned in the Attorney General's suit, but the company did have PSAs with brokers. The company suspended payments under existing agreements and has no plans to enter into any new PSAs with any brokers or agents. The company's parent announced in its September 2004 Form 10Q that it was not presently aware of any employees having engaged in bid rigging and it had hired an outside legal firm to conduct an internal review with respect to these issues as a proactive measure.

Hurricanes and Typhoon

Arch Capital Group Ltd. (Bermuda) announced on October 6, 2004, that, based upon current estimates, it expects net losses, on an after tax basis, resulting from Hurricanes Charley, Frances, Ivan, and Jeanne and Typhoon Songda to reduce 2004 third quarter net income by approximately $140 million. The company provided an estimate of its share of these losses at approximately $20 million after tax.

Lawyer Professional Malpractice Coverages

Arch Capital Group Ltd. (Bermuda) announced in a December 3, 2004, press release that it received a subpoena from the New York Attorney General requesting certain information regarding its underwriting activities with respect to insurance coverages provided to lawyers and law firms for acts of professional malpractice. Arch Capital Group Ltd. noted it intended to cooperate with this request. Total group premium for this coverage was reported to the examiner to be approximately $55.8 million for the year ended December 31, 2004. The company's share of this total business of the group was approximately 8.8%.

Stipulation and Order

With the filing of the company's 2004 Annual Statement it was discovered the company failed to meet the risk-based capital requirement of 275% in the Stipulation and Order.

A recommendation has been made in the “Summary of Current Examination Results,” “Reinsurance” section about complying with all requirements in the Stipulation and Order.